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A statute of limitations restricts the Internal Revenue Service's (IRS) audit and assessment authority to 3 years after a tax return is due or filed, whichever comes later. If more time is needed to resolve a tax examination satisfactorily, the statute period can be extended by written agreement (waiver) between IRS and the taxpayer. Findings/Conclusions: Waivers were requested in about two percent of the many audits conducted by the Atlanta, San Francisco, and Seattle IRS district offices during 9 months selected between October 1974 and October 1975. The reasons given for requesting a waiver do not always explain the underlying cause for not resolving the examination in time. The taxpayer has three options on a waiver--agree to waiver, propose conditions to waiver, or refuse waiver--but he quite often is not informed of alternatives. About 20 percent of interviewed taxpayers who agreed to a waiver indicated that they would have made other decisions had they known the choices; about 24 percent felt pressured into agreeing. The number of waivers could be reduced by amending IRS policies and procedures. IRS could enhance its public image by requesting fewer waivers and providing more complete and consistent information when requests are made. Recommendations: Taxpayers should be provided with complete and consistent explanations of their rights and options concerning waivers. Taxpayers should be permitted greater leeway in proposing waiver conditions and their conditions should be more readily accepted. Priority handling techniques should be applied for cases nearing expiration of the statutory period. A waiver request should be made only after priority processing results indicate the need for more time. The use of open-ended waivers should be expanded. A statement should be added to IRS request form for fixed-period waivers noting that the period will end on the agreed upon date or after assessment, whichever comes first. (Author/SS)

00293



*REPORT TO THE JOINT COMMITTEE
ON TAXATION
CONGRESS OF THE UNITED STATES
BY THE COMPTROLLER GENERAL
OF THE UNITED STATES*

Extending The Tax Assessment
Period: Why, How Often, And
What Improvements Can Be Made

Internal Revenue Service
Department of the Treasury

IRS' authority to audit a tax return and assess the taxpayer for any related tax change is limited by law to a 3-year period. This statutory period can be extended--waived--through written agreement between IRS and the taxpayer.

The requirement that both the taxpayer and IRS must agree provides the waiver process built-in protection against abuse. However, taxpayers, when asked to agree to a waiver, are not usually informed of alternative actions.

In practice, waivers are infrequent. Nevertheless, IRS can enhance its taxpayer relationships by reducing the number of waivers obtained and providing taxpayers more complete and consistent information when it requests waivers.



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-137762

To the Chairman and Vice Chairman
Joint Committee on Taxation
Congress of the United States

This report, one of a series in response to your Committee's request, addresses the frequency and reasons for extending the 3-year statutory period for assessing taxes and what the Internal Revenue Service can do to improve the extension process.

Upon release of this report by the Joint Committee, copies will be sent to the Director, Office of Management and Budget; the Secretary of the Treasury; and the Acting Commissioner of Internal Revenue.

A handwritten signature in black ink, reading "Thomas A. Skates".

Comptroller General
of the United States

COMPTROLLER GENERAL'S REPORT
TO THE JOINT COMMITTEE ON
TAXATION

EXTENDING THE TAX ASSESSMENT
PERIOD: WHY, HOW OFTEN, AND
WHAT IMPROVEMENTS CAN BE MADE
Internal Revenue Service
Department of the Treasury

D I G E S T

A statute of limitations restricts the Internal Revenue Service's audit and assessment authority to 3 years after a tax return is due or filed, whichever comes later. If more time is needed to resolve satisfactorily a tax examination, the statute period can be extended through written agreement between IRS and the taxpayer. Such extensions are commonly called waivers.

How often do waivers occur? Are taxpayers provided sufficient information on which to base their waiver decisions? Do taxpayers perceive pressure in IRS' waiver request? Can the waiver process be improved? GAO's review answered these questions.

IRS does not often request a waiver. Waivers occurred in only about 2 percent of the almost 50,000 audits closed by the Atlanta, San Francisco, and Seattle IRS district offices during 9 selected months within the period October 1974 through October 1975. (See p. 16.)

IRS requests and the taxpayer agrees to waivers for different reasons because they view the waiver from different perspectives. (See pp. 19 and 27.) These reasons do not always explain why waivers are needed--the underlying cause for not resolving the tax examination during the original statute period. (See p. 19.)

When confronted with a waiver request, the taxpayer has three basic choices, the rights and options varying with each--(1) agree to the waiver as requested by IRS, (2) propose waiver terms and conditions, or (3) refuse waiver agreement thereby forcing IRS to conclude the tax examination within the original statute period.

Interviews with IRS personnel, taxpayers, and taxpayer representatives disclosed that the taxpayer's decision is not always an informed one because IRS often provides insufficient information about waiver alternatives. Seventeen interviewees (about 20 percent) told GAO that knowledge of alternatives would have affected their decision to agree to the IRS waiver request. (See p. 29.)

Twenty interviewees (about 24 percent) were influenced by the manner in which IRS made the waiver request. They felt pressured into extending the statute period. Examples of this pressure included alleged or perceived threats of IRS retaliatory action should the waiver be refused. The general lack of information regarding taxpayer rights and waiver alternatives probably accounts for part of this feeling of ill will. (See p. 32.)

The interviews, supplemented by a review of case files, also showed that the number of waivers requested can be reduced by amending IRS policies and procedures. IRS can reduce the number of waivers requested by

- using priority handling techniques, especially for agreed cases (see p. 22), and
- expanding the use of open-ended waivers to cases for which the time required for resolution is difficult or impossible to predict. (See p. 24.)

In addition to reducing waiver frequency, IRS can exercise more care in determining waiver length. (See p. 24.)

Part of IRS' mission is to enhance public confidence in its integrity, the efficiency of its operations, and the equity of the tax system. IRS can further this mission and enhance its relationship with taxpayers by requesting fewer waivers and providing more complete and consistent information when requests are made.

Accordingly, GAO recommends that the Commissioner of Internal Revenue, through appropriate policy and procedural revisions:

- Provide taxpayers with complete and consistent explanations, orally and in writing, of their rights and options when faced with a waiver decision.
- Permit the taxpayer greater leeway in proposing waiver conditions and accept those conditions proposed that are reasonable in light of other alternatives available to IRS.
- Require that priority handling techniques be applied for cases nearing expiration of the statutory period.
- Require that a waiver request be made only after priority processing results demonstrate that more time is needed.
- Expand the use of open-ended waivers, particularly for tax examinations that cannot be closed within the foreseeable future.
- Add to the IRS forms used to secure fixed-period waivers a statement that the waiver period will end on the agreed date or after assessment, whichever comes first.

The Commissioner of Internal Revenue said that while the 2-percent waiver incidence GAO found reflects favorably on existing IRS policies and procedures, IRS will revise them in line with GAO's recommendations. (See app. I.)

Specifically, IRS will, when making waiver requests, provide taxpayers with complete and consistent explanations, orally and in writing, of their rights and options. IRS will also encourage greater use of conditional waivers and explore the feasibility of developing additional guidelines for their preparation.

To reduce waiver incidence, IRS will establish a requirement directed toward eliminating those waivers being obtained prematurely and expand the use of open-ended waivers. IRS will also terminate fixed-period waivers on the earlier of either the assessment date or agreed date.

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ABBREVIATIONS

GAO	General Accounting Office
IRS	Internal Revenue Service

CHAPTER 1

INTRODUCTION

In English common law there is a maxim, "The lapse of time does not bar the right of the Crown." Strictly interpreted, this maxim would allow the Government to initiate claims, assessments, or other legal actions without regard to time constraints. This open-ended doctrine has been limited over the years through laws--statutes of limitations--establishing specific time frames for certain types of actions. One such statute applies to the assessment of Federal taxes and affects both the Internal Revenue Service (IRS) and the taxpayer.

STATUTE OF LIMITATIONS ON TAX ASSESSMENTS

To protect taxpayers from untimely tax examinations, the Congress established a statute of limitations on tax assessments. Without such a statute, the Federal Government, through IRS, could examine any filed tax return, regardless of age, and make tax assessments as appropriate.

Immediately prior to the Revenue Act of 1934, IRS' authority to assess taxes was limited to 2 years after a tax return was filed. Because experience demonstrated that 2 years was insufficient for IRS to adequately perform thorough tax audits and prepare accurate tax statements, the 1934 act increased the limitation period to 3 years. The Internal Revenue Code of 1954, the current tax law, retained the 3-year period beginning on the due or filing date of a tax return, whichever is later.

The 3-year limitation on tax assessment is a general rule that does not apply to false, fraudulent, or unfiled tax returns. In addition, specific conditions, such as a 25-percent omission of income, cause the statute period to be automatically extended beyond 3 years. (See app. II.)

Agreement to extend the statute of limitations period

Since all activities leading to and including tax assessment may not be completed before the 3-year statutory period expires, the Internal Revenue Code includes a provision to extend the original period of limitation. Such extensions are permitted by the Code when both the taxpayer and IRS agree in writing before the existing statutory period expires. The Code, however, specifies neither the length of the extension period nor the number of extension agreements that can be made. Except for estate taxes the

extension provision applies to all tax types (for example, income, gift, and excise).

These extension agreements are commonly called waivers or consents.

REVIEW OBJECTIVES AND SCOPE

The Joint Committee on Taxation requested that we review the procedures for waiving the statute of limitations period and determine the basis for extensions on the part of both IRS and the taxpayer, including cases involving more than one waiver. We also looked into:

- How frequently waivers are obtained.
- What information is provided to taxpayers on which to base their waiver decisions.
- What opportunities are available to improve the waiver process.

Our review focused on the waiver process as conducted within IRS' Audit Division. ^{1/} We reviewed sections of the Internal Revenue Code as well as IRS regulations, policy statements, and procedural guidelines. Our review was performed at the IRS national office in Washington, D.C.; IRS regional offices in Atlanta and San Francisco; and IRS district offices in Atlanta, San Francisco, and Seattle.

Using statistical sampling techniques (see pp. 16 and 27), we examined 434 tax returns involving 300 taxpayers and 697 waiver agreements. We interviewed IRS personnel knowledgeable with 245 of the taxpayer cases in our sample. We also interviewed 83 of the sampled taxpayers or their representatives. We are 95 percent confident that our sample results are representative of the total waivers obtained for audits closed by the three districts during the sampled period.

^{1/}Waivers to the assessment period can also be obtained by other IRS offices and divisions such as the Office of International Operations and the Appellate Division. We concentrated on the Audit Division, however, because it affects the greatest number of taxpayers, including those who pay individual and corporate income tax.

CHAPTER 2

THE SELECTION, AUDIT, AND APPEAL PROCESSES:

HOW THEY WORK

The Internal Revenue Service selects and audits tax returns ^{1/} to encourage the highest possible degree of voluntary compliance with the tax laws. In fiscal year 1975, IRS audited about 3.6 million ^{2/} of the 110 million tax returns (all types of taxes) filed in calendar year 1974.

THE SELECTION PROCESS

IRS determines how many returns will be audited each year through an annual planning process. The plan is developed by return type--individual, corporate, etc.--and class--income or asset level. Returns are then selected in several ways to accomplish the plan.

The primary selection method is based on a computer program which screens and numerically scores tax returns according to a mathematically determined probability of error. The highest scored returns are then reviewed manually to confirm audit potential.

Other selection techniques employed by IRS include a manual review of returns showing adjusted gross incomes above a certain level and returns for which refund or credit claims have been filed. In other instances, errors found during the audit of a return may lead the examiner to select

^{1/}We have issued to the Joint Committee on Taxation three reports on IRS' selection and audit of tax returns: "How The Internal Revenue Service Selects Individual Income Tax Returns For Audit," GGD-76-55, Nov. 5, 1976; "Audit Of Individual Income Tax Returns By The Internal Revenue Service," GGD-76-54, Dec. 2, 1976; and "Audit Of Fiduciary Income Tax Returns By The Internal Revenue Service," GGD-76-33, Apr. 16, 1976.

^{2/}The 3.6 million includes 2.3 million district and 1.3 million service center audits. We considered any instance of taxpayer contact by the service center audit division as a service center audit. IRS, however, considers few of these contacts to be audits. Our differing positions are presented on pages 56 through 58 in the above listed report on the selection of individual income tax returns.

and audit additional returns filed by that taxpayer or the returns of related taxpayers, such as business partners. Still other returns may be selected because of information gathered during criminal investigations.

THE AUDIT PROCESS

The audit of a return may be accomplished through correspondence, or can take place in an IRS office, the taxpayer's home or place of business, or in the office of the taxpayer's accountant or attorney. Audit location is governed by such factors as return complexity and the best interest of the Government and taxpayer.

Upon completion, IRS informs the taxpayer whether the audit disclosed a tax deficiency, an overpayment, or no change in tax liability. The audit findings are subject to possible review by the examiner's supervisor and a separate staff. These reviews are to assure both the taxpayer and IRS that the findings are correct. The IRS examining officer may recontact the taxpayer if questions related to the audit findings are raised during the review process.

Once IRS is satisfied that the audit findings are correct, the tax return and examination documentation are processed through various procedural steps and sent to a focal point in a service center. There, processing is continued to record the assessment and ultimately update the taxpayer's account.

APPEAL PROCESSES

Once informed of the audit findings, a taxpayer who disagrees may either appeal within IRS' administrative system or take the case directly to a judicial court. Most taxpayers choose IRS' administrative appeals system, which is designed to minimize inconvenience, expense, and delay in settling contested tax cases. Additionally, use of the administrative system does not preclude the taxpayer from seeking subsequent judicial review of issues remaining unresolved. In the past 10 years, 97 percent of all disputed tax cases have been closed without judicial review.

Administrative appeal

IRS' administrative appeals system gives both the taxpayer and IRS opportunities to resolve disputed tax issues without incurring litigation costs. The system is founded on procedural rules established by the Internal Revenue Commissioner and the statute period for assessment continues to run during the appeal process.

The system provides two levels for appeal--district and regional. Each level is independent of the other, and a taxpayer may initiate an appeal at either level. If an appeal is initiated at the district (lower) level, any unresolved issues may be later appealed to the regional level. If agreement cannot be reached at either level, the taxpayer can continue the appeal within the judicial system.

Since the administrative appeal system is authorized by procedural rules rather than by law, access is not guaranteed to every taxpayer. If the time remaining in the statute period is not considered sufficient to accommodate the appeals process, IRS can deny the taxpayer the opportunity to administratively appeal the proposed tax adjustment if a waiver is not obtained. This does not abridge the taxpayer's constitutional right to due process because access to the judicial process is still available.

Judicial appeal

The taxpayer may either (1) appeal to the United States Tax Court before paying any additional tax IRS says is due or (2) pay the tax and then appeal to either the U.S. Court of Claims or a U.S. district court. These courts are independent of each other, and the decision of each may be appealed to a higher level in the Federal judicial system. Entry of a case on the U.S. Tax Court docket suspends the statute of limitations period.

CHAPTER 3

PROCEDURES FOR MONITORING TIME REMAINING IN THE STATUTE PERIOD AND FOR SOLICITING WAIVERS

The Internal Revenue Service cannot make a tax assessment after time has expired under the statute of limitations, even if the tax adjustment was determined before expiration. Taxpayers cannot administratively appeal a tax adjustment unless sufficient time remains under the statute. In view of these restrictions, IRS devised procedures to identify and monitor tax returns for which the statute period is nearing expiration. Once such returns are identified, IRS will usually act to prevent possible revenue loss, provide sufficient time for processing, and/or permit taxpayer access to the administrative appeals system.

The usual action taken by IRS to accomplish these objectives is to solicit a waiver extending the statute period. To provide consistency to the waiver process, IRS has developed standard forms for documenting waiver agreements and issued guidelines governing the solicitation and acceptability of waivers.

PROCEDURES FOR MONITORING EXPIRATION OF THE STATUTE PERIOD

The Internal Revenue Manual sets forth procedures for monitoring time remaining in the statute period. According to national office officials, these procedures are viewed as minimums which may be supplemented by field offices as deemed necessary. Each district we visited had implemented supplementary procedures.

National procedures

National procedures for the audit function place overall responsibility for statute period monitoring on IRS supervisors. The procedures provide that:

- The supervisor will establish a control file for tax returns having at least 120 remaining statute days.
- At least 90 days before the statute period expires, the supervisor will notify the IRS employee responsible for the return that expiration is approaching.
- When 30 days remain in the statute period, the supervisor is required to " * * * take immediate action to protect the Government's interest."

District office procedures

The three districts reviewed had implemented local procedures to supplement those in the manual. Local procedures were basically the same but varied somewhat in terms of when certain monitoring activities were to be undertaken. Each district, for instance, used a different date for audit supervisors to begin monitoring activities. These dates ranged from 6 to 12 months before statute period expiration.

Each district had also established requirements for certain numbers of days to remain in the statute period after the taxpayer's response to the audit findings. If less than the specified days remained, the procedures required examiners to solicit waivers.

If the taxpayer agreed to the audit findings, all three districts required that waivers be solicited if less than 120 days remained in the statute period. This time was to allow review of the audit findings, including possible re-contact with the taxpayer; completion of administrative steps for transmitting the return to a regional processing center; and assessment processing within the center.

If the taxpayer disagreed, however, and wished to appeal the audit findings, Seattle required that waivers be solicited if less than 180 days remained in the statute period and the Atlanta and San Francisco districts required that waivers be solicited if less than 270 days remained. This variance apparently resulted from different estimates among the districts regarding the time needed for internal review, possible appeal extensions, assessment processing, and potential slippage.

ACTIONS AVAILABLE AS STATUTE PERIOD APPROACHES EXPIRATION

As the statute of limitations period approaches expiration, IRS must choose a course of action that will be in the Government's best interest. The alternatives include:

- Soliciting a waiver to extend the statute of limitations period.

- Issuing a statutory notice of deficiency 1/suspending the statute of limitations.
- Making a jeopardy assessment if the case circumstances include the requisite conditions. 2/
- Accelerating the audit and return processing.
- Foregoing examination of the return.

IRS procedures, however, suggest that the first alternative--soliciting a waiver--should be used and that, if a timely waiver cannot be obtained, a statutory notice of deficiency should be issued.

WAIVER POLICY

IRS generally attempts to complete all audit activity within the original statute period. Even though IRS procedures require employees to secure waivers to prevent the statute period from expiring, IRS policy indicates management's desire to limit waiver use.

IRS' stated policy is to obtain waivers only in cases involving unusual circumstances and to keep to an absolute minimum the number of waivers obtained. The policy further states that once a waiver is obtained every effort should be made to close the case at the earliest possible date to avoid renewal waivers. Among the circumstances that the policy recognizes as justifying initial or renewal waivers are:

- Tax returns held in a suspense status awaiting a court decision on a similar tax case.
- The resolution of complex or intricate questions of fact or doubtful issues of law.

1/The notice gives taxpayers 90 days (150 days if the taxpayer resides outside the United States) to either agree to the proposed increase in tax or petition the Tax Court for a hearing. The statute of limitations period is suspended during the notice period, and assessments are made after the notice period expires unless the taxpayer agrees to the proposed adjustment or petitions the Tax Court.

2/We issued a report to the Joint Committee on Taxation on IRS' use of jeopardy assessments: "Use Of Jeopardy And Termination Assessments By The Internal Revenue Service," GGD-76-14, July 16, 1976.

--Other conditions ordinarily beyond the control of IRS. (The policy does not specify such conditions, but we identified instances obviously fitting this category, such as reconstruction of lost or destroyed tax records and taxpayer-caused delay.)

TYPES OF WAIVERS

The Code addresses neither the length of the extension period nor the activities which may be conducted during the period. Rather, it leaves these determinations to IRS and the taxpayer. It does, however, stipulate that both parties must reach written agreement before the extension becomes effective. Usually, waiver agreements do not include restrictive statements. Without restrictions, IRS has the same audit authority and the taxpayer the same appeal opportunities during the extension as under the original statute period.

To provide consistency to the waiver process, IRS developed specific forms to document written agreement and established procedural guidelines regarding acceptability of restrictive conditions. Two basic types of forms exist--one sets a specific expiration date for the extension, the other does not. Therefore, once IRS decides to request a waiver, it must also decide what type of waiver to request and whether restrictive conditions are appropriate.

Length of extension

IRS policy stipulates that the extension period requested should be " * * * no longer than is necessary to complete the examination and administrative action incident to the closing of the case." Waivers are either for a fixed duration or open-ended.

Fixed-period waivers set a specific expiration date for the extension period. IRS requires this type waiver for district audit and appeal activities. The form used to document these extensions varies according to tax type, such as individual and corporate income tax, excise tax, and employment tax.

IRS allows both fixed-period and open-ended waivers for tax cases scheduled for regional appellate conferencing. Under open-ended waivers, the extension period remains open until 90 days after either IRS or the taxpayer decides to conclude further appellate conferencing.

Restrictive conditions

In addition to conditions affecting the length of the extension, IRS will occasionally grant waiver agreements that limit further audit or appeal activity to specific tax issues. The primary IRS policy statement on such agreements, which are called restricted waivers, suggests that they be accepted "* * * in light of reasonable tax administration * * *." The policy and related procedures, however, place several limitations on the acceptability of these waivers and district officials said their use is rare or generally discouraged. Of the 697 waivers in our review, only 12 were restricted.

WAIVER NOTIFICATION PROCEDURES

Although either IRS or the taxpayer may request that the statute period be extended, IRS usually takes the initiative. Taxpayers are informed of waiver need through personal contact by IRS personnel and/or form letter.

The Internal Revenue Manual provides two form letters to be used by IRS field offices in requesting waivers. The first letter (see p. 11) is used for an initial request; the second (see p. 12) for followup if no response to the first is received. The three IRS districts we reviewed used these letters.

Another form letter provided by the manual is used to inform taxpayers of proposed audit adjustments and administrative appeal opportunities. The Atlanta and San Francisco districts also used this letter (as shown on pp. 13 to 15) to simultaneously advise the taxpayer of the need for a waiver if administrative appeal opportunities were to be exercised.

Information Copy Only

Social Security or Employer Identification Number:

Kind of Tax:

Tax Period Ended:

Consent Form Number:

While considering your Federal tax return for the period shown above, we found that the limitation period prescribed by law for assessing additional tax may expire soon. Unfortunately, more time is needed for us to consider all pertinent questions.

We would appreciate your extending the limitation period by signing all copies of the enclosed form and returning them within 10 days from the date of this letter. A self-addressed envelope is enclosed for your convenience. Upon acceptance of the consents, we will return a copy for your records.

By extending the limitation period, you will have time, if you choose, to present your views at conferences at District and Regional levels if we propose adjustments you do not agree to.

Thank you for your cooperation.

Sincerely yours,

District Director

Enclosures:
Copies of consent form
Envelope

Form L-64 (Rev. 2-73)

Date:

Consent Form Number:

Information Copy Only

Taxable Year:

Person to Contact:

Contact Telephone Number:

We recently wrote you that the period during which the law would permit assessment of any tax due for the above year will soon end. We asked that you extend this period by signing and returning both copies of a consent form we enclosed.

Since we have no record of a reply, we now ask that you either sign and return the forms, or let us know that you do not intend to do so. If we do not hear from you within a few days, we will have to act on your return before the statute of limitations expires.

If you have any questions, please contact the person whose name and telephone number are shown above.

Sincerely yours,

District Director

Form L-119 (Rev. 11-74)

Date:

Person to Contact:

Information Copy Only

Contact Telephone Number:

We have enclosed a copy of our examination report explaining why we believe an adjustment of your tax liability is necessary.

If you accept our findings, please sign and return the enclosed agreement or waiver form. If additional tax is due, you may want to pay it now. If so, please follow the enclosed instructions.

If you do not accept our findings, we recommend that you request a conference with a member of our conference staff to discuss the proposed adjustments. Most cases considered at conference are disposed of satisfactorily. You may want to send us, with your conference request, a written statement outlining your position. The enclosed instructions concerning unagreed cases explain your appeal rights.

If we don't hear from you within 30 days, we will have to process your case on the basis of the adjustments shown in the examination report. If you have any questions, please contact the person named above. A self-addressed envelope is enclosed for your convenience.

Thank you for your cooperation.

Sincerely yours,

District Director

GAO note: The following two pages contain the waiver request which is stamped or attached to the letter.

Form L-191 (Rev. 4-74)

The San Francisco district stamps the above letter with the following waiver request.

"IF YOU INTEND TO REQUEST A DISTRICT CONFERENCE OR PROTEST TO THE APPELLATE DIVISION, IT WILL BE NECESSARY THAT THE ATTACHED FORMS 872 FOR YEARS INDICATED BE EXECUTED AND RETURNED WITHIN 10 DAYS FROM THE DATE OF THIS LETTER."

The Atlanta district attaches to the above letter the following waiver request.

IMPORTANT NOTICE

In order for a District Conference to be arranged, or for referral of your case to the Appellate Division of the Regional Commissioner's office, an adequate time period must remain within the statutory period for assessment of a deficiency.

If you intend to request a District conference or consideration of your case by the Appellate Division, it will be necessary for you to sign all copies of the enclosed consent(s), Form 872, in accordance with the instructions shown on the bottom of the form. Both copies should then be returned to this office within fifteen (15) days from the date of the enclosed letter. Upon acceptance of the properly signed consent(s), one completed copy will be returned to you for your files.

CHAPTER 4

FREQUENCY OF WAIVERS AND WHY IRS REQUESTS THEM

WAIVER FREQUENCY

Internal Revenue Service policy is to hold waivers to a minimum number and avoid renewal whenever possible. IRS, however, does not keep statistics to show how well its policy is being implemented.

To calculate waiver frequency, we used as a universe Atlanta, San Francisco, and Seattle district office control records for audits completed during 3 selected months within the period October 1974 through October 1975. The 3 specific months for each district were selected either at random or on the basis of control record availability.

From the universe, we identified audits (tax returns) that possibly involved waivers. We randomly selected 730 of these returns to review. Our results showed that one or more waivers were obtained for 434 tax returns filed by 300 taxpayers.

Frequency for sample period

During the months reviewed, the districts had closed 49,665 tax return audits. Based on our review of 434 tax returns for which waivers were obtained, we estimate that 876 of those audits, or about 1.8 percent, included one or more waivers to the statute of limitations period.

The Atlanta, San Francisco, and Seattle districts obtained more than one waiver for 131 or 30.2 percent of the 434 returns. The majority of these are justified under IRS policy.

The number of taxpayers, returns, and waivers in our sample is shown in table I. The number of waivers per return is presented in table II.

Table I

Sample Composition by Tax Type

<u>Type of tax payment</u>	<u>Taxpayers</u>		<u>Tax returns</u>		<u>Waivers</u>	
	<u>Num- ber</u>	<u>Per- cent</u>	<u>Num- ber</u>	<u>Per- cent</u>	<u>Num- ber</u>	<u>Per- cent</u>
Individual income tax (Form 1040)	136	45.3	183	42.2	334	47.9
Corporate income tax (Form 1120)	90	30.0	117	26.9	196	28.1
Fiduciary income tax (Form 1041)	27	9.0	32	7.4	50	7.2
Federal excise tax (Form 720)	22	7.3	49	11.3	52	7.5
Highway motor vehicle and civil aircraft tax (Form 2290/4638)	11	3.7	16	3.7	20	2.9
Employment tax (Form 940/941)	11	3.7	34	7.8	41	5.9
Exempt organization (Form 990)	2	.7	2	.5	3	.4
Gift tax (Form 709)	<u>1</u>	<u>.3</u>	<u>1</u>	<u>.2</u>	<u>1</u>	<u>.1</u>
Total	<u>300</u>	<u>100.0</u>	<u>434</u>	<u>100.0</u>	<u>697</u>	<u>100.0</u>

Table II

Number of Waivers per Sampled Tax Returns

Number of returns by tax type	Number of waivers per return				Total waivers (note b)
	<u>1</u>	<u>2</u>	<u>3</u>	4 or more (note a)	
Individual income tax (Form 1040)	123	23	17	20	334
Corporate income tax (Form 1120)	79	19	9	10	196
Fiduciary income tax (Form 1041)	14	18	0	0	50
Federal excise tax (Form 720)	46	3	0	0	52
Highway motor vehicle and civil aircraft tax (Form 2290/4638)	12	4	0	0	20
Employment tax (Form 940/941)	27	7	0	0	41
Exempt organization (Form 990)	1	1	0	0	3
Gift tax (Form 709)	<u>1</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>1</u>
Total	<u>303</u>	<u>75</u>	<u>26</u>	<u>30</u>	<u>697</u>

a/The most waivers for any return was eight. Four sampled returns had eight waivers each.

b/Represents the sum of the number of returns in each column times the number of waivers per return shown in column heading.

WHY IRS REQUESTS WAIVERS

A waiver is based on mutual agreement between IRS and the taxpayer. Even so, the parties agree to waivers for different reasons because they view the waiver from different perspectives. IRS usually views its reasons for waiver requests in terms of an immediate need for additional time. As a result, the underlying cause for not resolving the tax examination during the original statute period is not always identified.

Identification and analysis of the underlying causes for our sampled waivers disclosed opportunities for IRS to enhance its relationships with taxpayers by requesting fewer waivers and exercising more care in establishing length of waiver periods. (Taxpayers' reasons for agreeing to waiver requests are discussed in ch. 5.)

Immediate reasons for waiver requests

IRS' main reason for requesting waivers is to avoid potential revenue loss. While this is the central concern, IRS generally views the specific reasons for waiver requests in terms of its immediate needs--more time to complete whatever activity is necessary to resolve the case. For example:

- For uncompleted audits, IRS requests waivers to permit satisfactory completion.
- For completed audits resulting in unagreed tax adjustments, IRS requests waivers to permit administrative appeal in hopes of resolving the disagreement at the lowest possible level.
- For completed audits resulting in agreed tax adjustments, IRS solicits waivers to permit assessment through normal routines.

Underlying causes for waiver requests

By reviewing sampled tax files and talking to IRS personnel, we identified the underlying causes for not resolving the tax examinations during the original statute period--the reasons behind the need for the waivers. These reasons and the frequency with which they occurred in our sample are summarized in table III.

Table III

Underlying Causes for Sampled Waivers

	<u>Initial waiver</u>	<u>Renewal waivers</u>	<u>Total waivers</u>
Tax return manually selected for audit late in the statute period based on the receipt or development of related information	173	0	173
Coordination of simultaneous audits involving multiple taxpayers and/or returns	50	45	95
Tax return held in a suspense status awaiting some external information (e.g., appellate or court decision on a related case)	51	107	158
Indication of fraud	21	23	44
IRS- or taxpayer-caused delays:			
IRS (e.g., change of examining officers, review process disclosed need for additional information)	18	14	32
Taxpayer	18	7	25
Combination	11	7	18
Tax case transferred to appellate division	2	19	21
Large or complex tax case	28	16	44
Reconstruction of lost or destroyed tax information	3	7	10
Postponed determination of activity as business or hobby	7	0	7
Time for continued processing of tax refund cases to be reviewed by Joint Committee on Taxation	2	0	2
Waivers obtained for returns subsequently closed during the original statute period:			
Waivers to permit routine processing of agreed cases	11	0	11
Waivers to permit audit completion and/or administrative appeal	36	0	36
Unable to determine	<u>3</u>	<u>18</u>	<u>21</u>
Total	<u>434</u>	<u>263</u>	<u>697</u>

The major underlying cause for initial waivers was receipt or development of information which led IRS to begin auditing tax returns near the end of the statutory period. The later in the statutory period an audit is begun, the less time available for completing all necessary activity and the greater the possibility that a waiver will be needed. Late initiation of audit activity accounted for 173 or 39.9 percent of the initial waivers in our sample.

IRS had begun the late activity on the sampled returns primarily as a result of information developed during audits of other returns or referrals from sources either inside or outside IRS. The sampled returns had been manually selected subsequent to development or receipt of this information. For example, of the 173 waivers in the late selection category:

--48.6 percent (84 waivers) were caused by multiple year pickups. In these instances, errors found during the audit of an initially selected return led the examiner to select and audit additional returns of that taxpayer. The statutory period for these additional returns was about to expire thereby necessitating a waiver to provide time to complete necessary activities.

--31.2 percent (54 waivers) were caused by related pickups. Such audits occurred when the audit of one taxpayer caused the audit of a related taxpayer's return. For example, the audit of one business partner disclosed the need to audit the returns of the other partners.

--11.6 percent (20 waivers) were caused by referrals. Such returns were audited on the basis of a referral from inside IRS (for example, the Intelligence Division, the Collection Division, or the Appellate Division) or outside IRS (for example, the Justice Department or a State tax agency).

Suspense cases represented the major cause of renewal waivers in our sample--107 (40.7 percent) of 263 waivers. In these instances, tax returns were held in a pending or suspense status while external information necessary for an accurate tax determination was being developed. Examples of such cases included postponement of audit completion

--pending the outcome of a related case being appealed through the administrative or judicial systems and

--until technical advice was rendered from IRS' national office on a complex tax issue.

We did not evaluate the validity of waiver need in terms of tax results. Such an evaluation would logically encompass a determination of the results that would have been achieved had the statute period not been extended. This determination was not possible from a practical standpoint at the time of our review. We did, however, address other aspects of the waiver process.

Analysis of the underlying causes shows that opportunities exist to reduce waiver frequency and, thereby, the number of taxpayers confronted with waiver requests. Opportunities also exist to better assure taxpayers that the waiver length requested is reasonable. These opportunities are discussed below. Other opportunities to improve the waiver process from the taxpayer's point of view are discussed in chapter 5.

NUMBER OF WAIVERS CAN BE REDUCED

While waiver extent for the period reviewed was less than 2 percent of total tax returns audited, this volume can be further reduced without detriment to the Government's best interest. Closer review of waiver need, priority handling of cases nearing statute expiration, and increasing use of open-ended waivers can reduce waiver frequency.

Better review of waiver need

More closely reviewing the need for waivers in light of existing mechanisms to speed case processing would reduce the number of waivers. Our sample included 47 waivers obtained for returns which were subsequently closed by the districts during the original statute period or within an average of 8.6 days after it would have expired. Thirty-two were closed within the original statute period.

Each district reviewed required that 120 days remain in the statute period after the taxpayer agreed to the audit findings. This time was considered necessary to move the case through the processes of internal review, administrative steps necessary before forwarding the case to a service center, and assessment processing within the center. If it appears that remaining statute time will not routinely accommodate this processing, district procedures direct examiners to solicit a waiver.

Eleven of the 47 waivers were obtained solely to comply with this 120 day requirement. Each was the only waiver for

the respective tax return; however, each return was subsequently closed within the original statute period or an average of 9.6 days thereafter.

The other 36 waivers were obtained for cases which were unagreed or incomplete at the time. These waivers were obtained from 1 to 14 months before expiration of the original statute period. More than half were obtained with 4 or more months remaining in the original period. Nevertheless, all 36 cases were subsequently agreed to and closed during the original statute period or within an average of 8.1 days after it would have expired.

When less than the minimum number of days established by district procedures remain in the statute period for agreed and unagreed cases, processing can be accelerated by according these cases priority, hand-carrying between processing steps, and making the assessment by telephone. For example, the San Francisco district's procedures for two organizational elements within the audit division--the review staff, which provides a separate review of the audit findings to insure correctness, and the service branch, which prepares the cases for forwarding to the regional service center--provide that:

1. The review staff:

--Will accord statute cases the highest priority when assigning cases for computation review.

--Will see that all statute cases are expedited when assigned for technical review.

--Will hand-carry approved, agreed cases to the chief of the staff when less than 25 days remain in the statute period. The chief will see that an assessment is made by telephone.

2. The service branch:

--Will ensure that statute cases are accorded the highest priority in processing cases received from other branches. Approved, agreed cases will be hand-carried to the chief of the review staff for telephone assessment when less than 25 days remain in the statute period.

While these mechanisms are available, they are not always used to provide accelerated processing of cases, especially those that are agreed. If a taxpayer refuses to grant a waiver, however, IRS is faced with making an

assessment before the statute period expires or losing the revenue involved. In such instances, IRS is forced to accelerate case processing through existing mechanisms as discussed above.

We believe that IRS can avoid many waivers by more closely reviewing waiver need and by postponing the request decision until the case has been afforded the same accelerated processing that would have been employed had the waiver been refused.

Increased use of open-ended waivers

The number of waivers can be further reduced by permitting use of open-ended waivers at the district office level. IRS currently permits such waivers to be used only for regional appellate division activity. IRS rationale for using open-ended waivers at this level is based on the difficulty in forecasting the time required for appellate review.

A similar forecasting problem exists for tax cases held in suspense at the district office level. The single greatest reason for the multiple waivers in our sample was to hold tax returns in suspense while awaiting results from a similar tax case being appealed through the administrative or judicial system. Four of the sampled returns had eight separate waivers, holding the statute periods open for as long as 8 years beyond the original expiration dates.

Use of open-ended waivers for cases being held in suspense at the district office level could substantially reduce the paperwork, effort, and taxpayer contacts necessary to monitor waiver expiration dates and periodically secure renewal waivers. Although this would not eliminate the need for an initial waiver, it would reduce the number of renewal waivers obtained.

Longer-than-necessary waiver periods

Statute extensions were often for much longer periods than necessary to bring a case to resolution. This is contrary to IRS policy that "* * * the period of extension will be no longer than is necessary to complete the examination and administrative action incident to closing the case."

For example, for 35 tax returns randomly selected from our total sample, the extension period exceeded district closing dates by an average of about 8.6 months. The expiration dates for six other waivers were 20 or more months past the district closing date for the returns.

IRS can legally reopen a case at any time before the waiver period expires. We found no evidence of such reopenings; however, should this situation occur it could, in our opinion, impact adversely on IRS-taxpayer relationships.

One solution to predicting a no-longer-than-necessary waiver period is embodied in a characteristic of the open-ended waivers used by the IRS appellate activity. Open-ended waivers, unlike fixed-period waivers, terminate after the assessment is made, thereby providing the taxpayer some assurance that the waiver period is for no longer than necessary. The same provision should be included in a fixed-period waiver.

CONCLUSIONS

The number of waivers obtained by IRS is small when compared to total audits closed. Nevertheless, IRS can reduce the number of waivers solicited--thereby reducing the number of taxpayers contacted--by more closely reviewing waiver need and by amending existing policies and procedures. IRS can also better assure taxpayers that waiver periods requested are reasonable in length. These actions would enhance IRS-taxpayer relationships by reducing potential sources of taxpayer ill will.

RECOMMENDATIONS TO THE COMMISSIONER OF INTERNAL REVENUE

Accordingly, we recommend that IRS:

- Require that priority handling techniques be afforded cases nearing expiration of their statutory period.
- Require that a waiver request be made only after priority processing results demonstrate that more time is needed.
- Expand the use of open-ended waivers, particularly for tax examinations that cannot be closed within the foreseeable future.
- Add to the IRS forms used to secure fixed-period waivers a statement that the waiver period will end on the agreed date or after assessment, whichever comes first.

IRS COMMENTS

The Commissioner of Internal Revenue said (see app. I) that the 2-percent waiver incidence shown by our report reflects favorably on IRS policies and procedures which are designed to keep requests for extensions of the statutory period to a minimum. Nevertheless, he said IRS recognizes that some offices are obtaining waivers prematurely and will revise current guidelines to provide a general rule as to when waivers should be requested.

The rule proposed by the Commissioner, as we understand it, will set a point near the statutory expiration date and direct that waivers should generally not be requested before this point is reached. The rule should require priority handling when appropriate.

The Commissioner recognized the merit of open-ended waivers for certain situations. In particular, he agreed with us that their use for audit cases which are suspended pending the outcome of related litigation will reduce the need for renewal waivers. Accordingly, IRS will expand the use of open-ended waivers to such cases as well as to other mutually advantageous situations.

The Commissioner said that barring any unforeseen legal problems, IRS will adopt the recommendation to terminate fixed-period waivers on the earlier of either the assessment date or the agreed date.

CHAPTER 5

WHY TAXPAYERS AGREE TO WAIVER REQUESTS

Interviews with taxpayers and taxpayer representatives disclosed that they generally agreed to waive the statute period to avoid something, to obtain something, or to cooperate with the Internal Revenue Service.

Taxpayers confronted with a waiver request must make a decision. Our review disclosed that this decision is not always an informed one because often IRS provides insufficient information.

TAXPAYER REASONS

We randomly selected 103 of the taxpayers in our sample for interview to obtain their reasons for waiver agreement. Of these we interviewed 83; the other 20 either could not be contacted or preferred not to participate. Our initial contact was with the taxpayer. If the taxpayer preferred, we interviewed the taxpayer's representative instead.

As shown in table IV, taxpayers have agreed to waivers to:

- Avoid something perceived as detrimental.
- Obtain additional time to permit resolution of the audit.
- Cooperate with IRS.

Each category is not necessarily independent of the other because the responses may be rooted in the taxpayer's emotional attitude toward IRS. For example, two taxpayers, each agreeing to a waiver in order to pursue administrative appeal, may have couched their respective responses in either a negative or positive vein; that is, to avoid a statutory notice of deficiency (avoid a perceived detriment) or to provide time for appeal (permit resolution of the audit).

Table IV

Reasons Taxpayers Agreed to Waivers

<u>Reason</u>	<u>Number of respondents</u>	<u>Percent of total</u>
Avoid something perceived as detrimental	27	32.5
A potential jeopardy or quick assessment	10	
A statutory notice of deficiency	6	
"Trouble" with IRS	6	
An arbitrary assessment	4	
A delinquent penalty	1	
Obtain additional time to permit resolution of the audit	20	24.1
To develop or reconstruct tax records	7	
To negotiate or appeal tax issues	7	
To await related appeal or technical advice	4	
To obtain money to pay the tax	2	
Cooperate with IRS or because it is mutually beneficial	19	23.0
Comply with advice from non-IRS source	8	9.6
Other	<u>9</u>	<u>10.8</u>
Total	<u>83</u>	<u>100.0</u>

TAXPAYERS ARE NOT PROVIDED COMPLETE
AND CONSISTENT INFORMATION

The information IRS provides when waivers are requested is often incomplete and inconsistent. Taxpayers, therefore, may not be aware of their full range of rights and available options when confronted with a waiver decision. Since the statute period cannot be waived without mutual agreement between IRS and the taxpayer, such agreements should be predicated on each party being fully informed of agreement consequences and available alternatives.

Options available to taxpayers

When asked to waive the statute period, a taxpayer has three basic choices, with the rights and alternatives varying under each. Specifically, the taxpayer can:

--Refuse to sign the waiver. When this happens, IRS normally issues a statutory notice of deficiency. This notice neither forces the taxpayer to make an immediate payment nor seek immediate judicial review. The notice gives the taxpayer 90 days (150 days if the taxpayer resides outside the United States) to either agree to the proposed tax increase or petition the Tax Court for a hearing. During this period, IRS can permit taxpayer access to the administrative appeals system. If agreement is not administratively reached, the taxpayer can petition the Tax Court for judicial resolution. Once the court has been petitioned, the taxpayer is afforded the opportunity to settle the case with IRS before trial. If the disagreement is still not resolved, the case is heard by the court.

Alternatively, the taxpayer can pay the disputed amount and file a claim for refund. The statute of limitations period for the tax return will end on the original expiration date, but the claim can undergo subsequent audit, review, and appeal.

Through yet a third alternative, the taxpayer can bypass all administrative opportunities for settlement and seek judicial resolution by the Tax Court or, after paying the disputed amount, the district court or Court of Claims.

--Sign an unconditional waiver. This permits IRS the same audit authority and the taxpayer the same appeal opportunities as under the original statute period.

--Propose a conditional or restricted waiver. The Internal Revenue Code addresses neither the length of the extension period nor the activities that may be conducted during the period. Rather, it leaves these determinations to IRS and the taxpayer. The determinations may include the length of the extension period and/or the specific tax issues. Any conditions, however, must be agreed to by both parties before the waiver becomes effective.

Information provided by IRS

Taxpayers are informed of the need for a waiver through a form letter and/or personal contact by IRS personnel.

The form letters neither explain the taxpayer's alternatives to agreement with the waiver nor what specifically will happen if waiver agreement is refused. (See pp. 10 to 15.) With the letter used after the tax adjustment has been determined, IRS usually encloses its publication on appeal rights. This publication explains the general mechanics of the appeals system but does not inform the taxpayer of rights or options regarding the statute of limitations and waivers.

Even when IRS employees request waivers through personal contact, the information provided is seldom sufficient to permit the taxpayer to make a fully informed decision. We interviewed IRS personnel who had dealt with 245 of the 300 taxpayer cases in our sample. The personnel who dealt with the other 55 taxpayer cases had either left IRS or were otherwise unavailable. The following table summarizes the interview responses.

<u>Extent of information</u>	<u>Number of taxpayers</u>	<u>Percent</u>
Taxpayer was not provided any information about alternatives	30	12.2
No information provided; IRS examining officer assumed taxpayer's representative was aware of possible alternatives	89	36.3
Form letter was only source of information	38	15.5
Taxpayer was told that IRS would make an immediate assessment (that is, issue a statutory notice of deficiency)	40	16.3
Taxpayer was informed of one or more specific alternatives	19	7.9
Taxpayer provided with publication on "appeal system"	15	6.1
Could not remember what taxpayer was told	<u>14</u>	<u>5.7</u>
Total	<u>245</u>	<u>100.0</u>

Taxpayer awareness of alternative actions

We informed the 83 taxpayers and representatives interviewed of the various alternatives to an unconditional waiver and asked them to what extent this information had been made available by IRS when waivers were requested. The following table summarizes their responses.

<u>Extent of information</u>	<u>Number of respondents</u>	<u>Percent</u>
Was not informed of any alternatives to the waiver as presented	47	56.6
Was told that the only option was to pay the proposed tax assessment	9	10.9
Had been informed of only one alternative course of action	3	3.6
Had been informed of only two alternative courses of action	13	15.7
Had been informed of three or more alternative courses of action	4	4.8
Question not answered	<u>7</u>	<u>8.4</u>
Total	<u>83</u>	<u>100.0</u>

Thirty-seven (about 45 percent) of the interviewees considered one or more of the alternatives to be appealing.

Seventeen of them specifically stated that knowledge of the alternatives would have affected their decision to sign the unconditional waiver requested by IRS. The favored alternatives were to:

- Obtain a waiver restricting the number of tax issues to be pursued or limiting further activity to administrative appeal. Thirty-two interviewees considered this alternative appealing with 12 specifically stating that it would have affected their waiver decision.
- Allow IRS to issue a statutory notice of deficiency and attend an administrative review conference during the 90-day notification period. Three interviewees considered this alternative appealing and said it would have affected their waiver decision.
- Pay the tax as proposed by IRS and subsequently submit a claim for refund. Two respondents considered this alternative appealing and said it would have affected their waiver decision.

Some taxpayers interviewed had been represented in their dealings with IRS, others had not. We recognize that when dealing with taxpayer representatives, IRS has little control over what is communicated between the representative and the client. However, IRS examining officers told us they generally do not inform taxpayer representatives of the alternatives to waiver agreement. This rationale is predicated on the assumption that tax practitioners are as knowledgeable about tax law as is IRS. Our interviews with representatives, however, disclosed that they are not always aware of all options.

THE WAY IRS REQUESTED WAIVERS INFLUENCED SOME TAXPAYERS' DECISIONS

The manner in which IRS requests waivers can influence taxpayer attitudes. As shown in table IV, 27 (about 33 percent) of the taxpayers or representatives we interviewed said they agreed to the waiver to avoid something they perceived as more detrimental. "Something more detrimental" included alleged or perceived threats of IRS retaliatory action should the waiver be refused.

Twenty (about 74 percent) of these interviewees said that they either believed or were told by an IRS representative that, should they refuse waiver agreement, IRS would issue a statutory notice of deficiency, make a jeopardy or quick assessment, or make an arbitrary assessment. These

actions were perceived as detrimental by the taxpayers who said they agreed to waive the statute solely to avoid such occurrences.

Statutory notice of deficiency

Should a taxpayer refuse waiver agreement, IRS must take some action to protect the Government's interest, and the usual action taken is to issue a statutory notice. This notice neither forces immediate payment of the proposed amount nor immediately forces the taxpayer into court.

Nevertheless, about 7.2 percent of the interviewees perceived this notice as more detrimental than the waiver. One taxpayer, for example, who said the only options IRS explained were to sign the waiver or receive a statutory notice of deficiency, expressed a feeling of "hopelessness" because there were no viable alternatives from which to choose.

Jeopardy or quick assessment

About 12 percent of the interviewees said they agreed, or advised their client to agree, to a waiver to avoid a potential jeopardy or quick assessment. Eight of the interviewees perceived this action only as a potential IRS retaliatory action. Two others said they were specifically told this by the IRS representative requesting the waiver.

For example, one representative who instructed his client to sign the waiver said he did so because he was "coerced and intimidated" by IRS statements that, in the event of waiver refusal, a jeopardy assessment would be made resulting in an "unbearable" court fight. In another instance, a representative strongly believed IRS would make a jeopardy assessment if the waiver was refused, although he was not told this by IRS.

The American Institute of Certified Public Accountants has brought similar occurrences to IRS' attention. During a September 3, 1975, meeting with IRS officials, members of the Institute's tax division said that, while IRS rules are clear as to limitations for issuing jeopardy assessments, it is not uncommon for revenue agents to threaten assertion of a jeopardy assessment in order to persuade taxpayers to extend the statute of limitations period. The Institute members expressed the opinion that this problem warranted repetitive instructions to IRS agents as well as better practitioner (taxpayer representative) knowledge about taxpayer rights. The IRS officials agreed to continue to emphasize, through training materials and future instructions, that threat of jeopardy assessment should not be

used to intimidate taxpayers or their representatives into signing a waiver. The IRS officials also requested practitioners to inform the examiner's supervisor of any attempt to use the jeopardy assessment procedure improperly.

We agree with the Institute that IRS should reemphasize its instructions that examiners are not to use threats of jeopardy assessment when soliciting waivers. We also agree that a need exists for better public knowledge of taxpayer rights and alternatives. Whether or not taxpayers are threatened with jeopardy assessments, the general knowledge that such action is within IRS' authority and the possibly unfounded fear that IRS may take such an action can cause the taxpayer consternation.

Arbitrary assessment

Four of the 83 taxpayers and taxpayer representatives interviewed said that the examining officer had threatened to propose an arbitrary tax adjustment if the taxpayer refused to sign the waiver.

According to IRS policy, tax adjustments for " * * * punitive, bargaining, or similar purposes" should not be made. It does, however, allow the amount of tax to be estimated when it is impossible to establish the exact amount. Such cases, like all others, are subject to possible review within IRS, and appeal opportunities are available should the taxpayer disagree with the proposed tax adjustment.

CONCLUSIONS

When requesting waivers to the statute of limitations period, IRS does not usually provide taxpayers with the data necessary for making an informed decision. Because they lack knowledge about waiver rights and alternatives, taxpayers may perceive pressure and/or personal detriment in the IRS request.

The laws relating to duress and undue influence maintain that a threat to do that which can be legally done is not duress. Whether legal or not, the manner with which IRS requested waivers adversely affected its relationship with taxpayers in our sample.

Part of IRS' mission is to enhance public confidence in its integrity, the efficiency of its operations, and the equity of the tax system. IRS can further this mission by reducing taxpayers' perceptions of personal detriment when confronted with a waiver request by providing more complete and consistent information regarding waiver agreement

consequences and alternatives. The full range of options and the consequences of each should be made known to the taxpayer. Only then will taxpayers be able to make informed decisions, and only then can the waiver agreement be construed as a mutual contract between equally informed parties.

RECOMMENDATIONS TO THE COMMISSIONER OF INTERNAL REVENUE

We recommend that IRS, through appropriate policy and procedural revision:

- Provide taxpayers with complete and consistent explanations, orally and in writing, of their rights and options when faced with a waiver decision.
- Permit the taxpayer greater leeway in proposing waiver conditions and accept those conditions proposed that are reasonable in light of other alternatives available to IRS.

IRS COMMENTS

The Commissioner of Internal Revenue said that written information explaining taxpayers' rights and options will be developed to accompany all IRS waiver requests. IRS personnel will also be instructed to orally explain the rights and options when they request a waiver.

The Commissioner agreed to permit, where possible, a greater degree of taxpayer participation in establishing waiver agreement content. He said the waiver agreement is a legal document which must be carefully worded, and in many situations it is not possible or practical to specify agreement conditions. However, IRS will encourage greater use of conditional waivers and explore the feasibility of developing additional guidelines for their preparation.

Department of the Treasury / Internal Revenue Service / Washington, D.C. 20224

Commissioner

JAN 18 1977

Mr. Victor Lowe
Director
General Government Division
U. S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Lowe:

Thank you for the opportunity to review your draft report to the Joint Committee on Internal Revenue Taxation entitled, "Opportunities for Improvement in Requesting Extensions to the Tax Assessment Period." As you suggested, representatives of your office and our Audit Division met on November 22 to discuss and resolve technical problems in the draft report.

We hope the readers of your report will recognize, as we are sure you do, the serious consequences that would result if the Service failed to take necessary steps to protect the valid interest of the Government. When the statutory period for assessment is expiring, the Service really has only two choices--secure a consent extending the statutory period or issue a statutory notice of deficiency. We prefer the former choice because it allows time for full and careful consideration of the issues.

We believe the recommendations in the report will provide the taxpayers with a greater understanding of the purpose of extensions and what options are available to them. We also believe the report reflects favorably on Service policies and procedures which are designed to keep requests for extension of the statutory period to a minimum.

In general, we agree with the recommendations. Attached are our comments regarding specific recommendations and other statements in the report. The comments are referenced to the applicable page number in the report.

With kind regards,

Sincerely,



Commissioner

Attachment

GAO note: Page references in IRS' comments may not correspond to pages in the final report.

GAO Report: "Opportunities for Improvement in Requesting Extensions to the Tax Assessment Period"

Page 4, Paragraph 1 and Footnote 2/

IRS selects and audits tax returns ^{1/} to encourage the highest possible degree of voluntary compliance with the tax laws. In fiscal year 1975, IRS audited about 3.6 million ^{2/} returns of the 110 million returns (all types of taxes) filed in calendar year 1974.

^{2/} The 3.6 million includes 2.3 million district and 1.3 million service center audits. We considered any instance of taxpayer contact by the Service Center Audit Division as a service center audit. See the above listed report on the selection of individual income tax returns.

Comments

We do not concur with GAO's assumption that any instance of taxpayer contact by the Service Center Audit Division be considered as an audit for the following reasons.

The IRS classifies the service center correspondence program into two distinct categories: district-type examinations and limited contacts. District-type examinations constitute an examination of books and records as defined by Section 7602 of the Internal Revenue Code; i.e., taxpayers are required to produce a part of their records (receipts, cancelled checks, etc.) to provide documentation or substantiation to support the income, deductions and credits claimed on their tax return. These examinations include the DIF correspondence type returns, Federal-State Cooperative programs, Social Security Administration examinations (OAR-7000) and claims. In FY 1975, IRS examined 112,550 returns in the service centers, about 0.10% of the 110 million returns filed in Calendar Year 1974.

The other category, limited contacts, involves isolated, special issues which do not require examination of books and records, i.e., taxpayers are not requested to provide part of their records to document

- 2 -

or substantiate the item being corrected. Thus, these contacts are not considered examination within the definition of Section 7602. This category includes the Unallowable Items Program, Information Returns Program, Head of Household Program and similar programs. These limited contacts accounted for 1.2 of the 1.3 million returns in the Service Center Program for FY 1975. We doubt that these limited contacts in total (recognizing a few may have a significant impact on compliance) have the same overall affect on compliance as do regular audits.

Consistent with our recommendation in GAO report GGD-76-55, we recommend all reference to the 1.2 million limited contacts as being "audits" be changed.

GAO note: We still considered any instance of taxpayer contact by the service center audit division as an audit. Our position on this matter is presented on pages 56 through 58 in GAO's report "How the Internal Revenue Service Selects Individual Income Tax Returns for Audit," GGD-76-55, Nov. 5, 1976.

GAO Report Title:

Opportunities for Improvement in Requesting Extensions to the Tax Assessment Period.

Page 28, Paragraph 1

We did not evaluate the validity of waiver need in terms of tax results. Such an evaluation would logically encompass a determination of the results that would have been achieved had the statute period not been extended.

Comment

We feel that an evaluation of waiver need in terms of tax results would necessarily involve the use of hindsight. Many times when we request a waiver, we have not been able to determine enough facts at that point to approximate the final results. That is the reason we found it necessary to request the additional time. When we determine the facts, there may or may not be substantial additional tax. In other situations, we know the exact amount of tax involved but are awaiting a court decision on the issue. Rather than finalizing our adjustment, we request an extension of the statutory period and place the case in suspense. If the court's decision is adverse to the Service's position, the need for the waiver in terms of tax results is nil. However, in both situations, we have taken an action which protects the Government's interest with the taxpayer's agreement.

GAO Report Title:

Opportunities for Improvement in Requesting Extensions to the Tax Assessment Period.

Page 33, Paragraph 1

Statute extentions were often for much longer periods than necessary to bring a case to resolution. This is contrary to IRS policy that "*** the period of extension will be no longer than is necessary to complete the examination and administrative action incident to closing the case."

Page 34, Recommendation:

It is recommended that IRS add to the IRS forms used to secure fixed period waivers a statement that the waiver period will terminate on the agreed date or later assessment, whichever comes first.

Comments

We do not fully share GAO's view that the additional time on an extension beyond the assessment date is a detriment to the taxpayer. While legally we could take further action, generally we do not. The additional time is mutually beneficial since it increases the period for which a taxpayer may file a claim for refund and also provides IRS time to effect further action, if necessary. Nevertheless, we recognize that the GAO and perhaps taxpayers, have perceived the additional time as a detriment. Therefore, barring any unforeseen legal problems, we will adopt the recommendation that "fixed date" consents will terminate on the earlier of the agreed-upon date or the assessment date.

GAO Report Title:

Opportunities for Improvement in Requesting Extensions to the Tax Assessment Period.

Page 34, Recommendation:

Accordingly, we recommend that IRS:

- Require that priority handling be afforded all cases nearing expiration of their statutory period
- Require that a waiver request be made only after priority processing results demonstrate a need for additional time

Comments:

We concur with the objectives of the recommendations. Current IRS policy contemplates that examination and disposition of income tax returns will be completed within 26 months in the case of individuals and 27 months in the case of corporations after the beginning of the period of limitations on assessment.

Service policy is supplemented by published objectives which state that the inventory of prior year returns at the end of our fiscal year should not exceed 35% of planned revenue agent examinations and 5% of planned tax auditor examinations. Also, we specifically require group manager approval before tax auditors are allowed to extend an examination to a prior year and we similarly control the extension of examinations by revenue agents by requiring group manager approval of the request for returns.

The GAO report states: "Waivers occurred in only about 2 percent of the almost 50,000 audits closed by the Atlanta, San Francisco, and Seattle IRS district offices during nine selected months within the period October 1974 through October 1975." We believe this statement demonstrates that we are accomplishing the objectives of the recommendations. Nevertheless, we recognize that some offices are securing consents prematurely and will

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revise the current guidelines to provide a general rule as to when consents should be requested.

GAO Report Title:

Opportunities for Improvement in Requesting Extensions to the Tax Assessment Period

Page 34, Recommendations:

It is recommended that the IRS expand the use of open-ended waivers, particularly for tax returns that cannot be closed within the foreseeable future.

Comments:

We concur with the general concept of this recommendation. In particular, the use of open-ended waivers in audit cases suspended by district offices pending the outcome of related cases in litigation will reduce the need for additional taxpayer contacts to secure renewal waivers. Accordingly, we will expand the use of open-ended waivers to include the district office level for cases formally placed in suspense status under current Manual procedures and other situations where the use of an open-ended waiver would be advantageous to both the taxpayer and IRS. However, we believe many tax practitioners will be reluctant to recommend the use of open-ended waivers to their clients except for suspense cases and then only if the waiver is restricted to the suspense issue.

GAO Report Title:

Opportunities for Improvement in Requesting Extensions to the Tax Assessment Period.

Page 46, Recommendation:

It is recommended that IRS through appropriate policy and procedural revision provide taxpayers with complete and consistent explanations, orally and in writing, of their rights and options when faced with a waiver decision.

Comments:

We concur with this recommendation. Appropriate revisions will be made to the Manual instructing authorized Service personnel to orally inform taxpayers of their rights and options when soliciting waivers. In addition, we will develop written information explaining taxpayers' rights and options. This information will accompany all requests for waivers solicited by the Service.

GAO Report Title:

Opportunities for Improvement in Requesting Extensions to the Tax Assessment Period.

Page 46, Recommendation:

It is recommended that IRS through appropriate policy and procedural revision permit the taxpayer greater leeway in negotiating waiver conditions and accept those conditions proposed which are reasonable in light of other alternatives available to IRS.

Comments:

We concur with this recommendation to permit a greater degree of negotiation with the taxpayer regarding the length of the extension period and whether a general or restricted consent will be secured.

A consent to extend the statutory period is a legal document. Any additional statements made on the printed forms to restrict assessment to certain issues must be legally sufficient to cover the "area of consideration" on the return. The restriction must be carefully written so that both the IRS and the taxpayer mutually understand the scope of the restriction as to issues. Otherwise, it is quite probable that legal disputes between IRS and the taxpayer might develop on the question of whether the statutory period was open for assessment on the issue as finally proposed.

There are many situations where it is not possible or practical to secure a restricted consent. Where an examination has not progressed to a point where all the issues are known, a restricted consent is not feasible. In other situations, the issues, while known, are so numerous that it is not practical to write a restricted consent. In still other situations, the issues, while known and few, are so complex that the use of a restricted consent would be unacceptable to the Service due to anticipated litigation. The Service would

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run the risk that the restrictions would be too narrowly construed by the courts to permit the use of alternative positions.

We will, however, encourage greater use of such consents in appropriate cases and will explore the feasibility of developing additional guidelines for the preparation of restricted consents.

CERTAIN EXCEPTIONS TO THE
3-YEAR STATUTE OF LIMITATIONS

<u>Exceptions</u>	<u>Statutory period</u>
1. False or fraudulent returns	No limitation
2. Failure to file a return	No limitation
3. Substantial omission from tax return	6 years
a. 25 percent of gross income (income tax)	
b. 25 percent of gross amount of estate (estate tax)	
c. 25 percent of total amount of gifts (gift tax)	
d. 25 percent of excise taxes	
4. The failure of a personal holding company to report certain items of gross income and all individuals who owned more than 50 percent of the value of outstanding capital stock at any time during the last half of the taxable year	6 years
5. Carrybacks	Statute periods for prior years remain open until the expiration of the base year statute period
a. Net operating loss	
b. Investment credit	
c. Capital loss	
d. Foreign tax	Statute periods for prior years remain open until 1 year after expiration of the base year statute period
6. Extension by agreement (waiver of statute of limitations period)	Statute period extended to date agreed upon
7. Request for a prompt assessment	18 months after receipt of written request

Exceptions

8. Statutory notice of deficiency

Statutory period

Suspends the running of the statutory period for 150 or 210 days

PRINCIPAL OFFICIALS
RESPONSIBLE FOR ADMINISTERING
ACTIVITIES DISCUSSED IN THIS REPORT

	<u>Tenure of office</u>	
	<u>From</u>	<u>To</u>
SECRETARY OF THE TREASURY:		
W. Michael Blumenthal	Jan. 1977	Present
William E. Simon	Apr. 1974	Jan. 1977
George P. Shultz	June 1972	Apr. 1974
COMMISSIONER OF INTERNAL REVENUE:		
William E. Williams (acting)	Feb. 1977	Present
Donald C. Alexander	May 1973	Feb. 1977
Raymond F. Harless (acting)	May 1973	May 1973
Johnnie M. Walters	Aug. 1971	Apr. 1973
ASSISTANT COMMISSIONER (COMPLI- ANCE):		
Singleton B. Wolfe	Mar. 1975	Present
Harold A. McGuffin (acting)	Feb. 1975	Mar. 1975
John F. Hanlon	Jan. 1972	Jan. 1975
DIRECTOR, AUDIT DIVISION:		
John L. Wedick, Jr.	June 1975	Present
Peter J. Medina (acting)	Mar. 1975	June 1975
Singleton B. Wolfe	July 1965	Mar. 1975